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TAGS: ECON EFIN PGOV VE
SUBJECT: BANKS UNDER PRESSURE

REF: CARACAS 577

Classified By: ECONOMIC COUNSELOR RICHARD M. SANDERS FOR REASON 1.4 D

SUMMARY

¶1. (C) Government intervention in the economy has taken another step forward with the issuance of regulations which force the banking sector to devote 10% of its lending portfolio to mortgage and home construction loans and which increase from 10% to 16% the portion which must be dedicated to the agricultural sector. 29% of bank loan portfolios are now prescribed by the GOV, with 26% at preferential interest rates, which could both force banks to both take on risky loans as well as reduce lending in other areas. Meanwhile, several private bank presidents, a former Superintendent of Banks, and two former Central Bank presidents may face charges of usury and fraud for having allowed loans with interest rates indexed to inflation. While the bankers say that they are on solid legal footing, they worry about the outcome in the highly politicized judiciary. Banks have been hugely profitable in recent years; the usury case may be pressure to keep them from complaining too hard about the increased demands being placed upon them, while focussing public attention on another presumedly exploitative private sector interest. END SUMMARY.

HOW SHOULD A BANK LOAN? AS THE GOV TELLS IT

¶2. (SBU) Based on a 2001 housing law, the National Housing Council (CONAVI), a GOV body, recently set a legal maximum for interest rates on mortgages of 11.36%, which was 65% of the average bank lending rate at the time of the decision. Lower-income borrowers can qualify for a rate three-quarters or even half of that maximum, and may also be eligible for subsidies from the government. CONAVI also directed that a minimum of 10% of each bank's lending portfolio be dedicated to housing loans, 3% to mortgages and 7% to home construction. In addition, the GOV recently required that banks increase the portion of their lending portfolios dedicated to agriculture from 10% in 2004 to 16% by June 2005, all with a maximum interest rate of 16%. These new requirements, in combination with an existing requirement that 3% of lending be committed to micro-loans (with no maximum rate), mean that 29% of all private sector bank lending is now directed by the GOV.

¶3. (C) Ignacio Salvatierra, President of the National Banking Council (a group with both private and public bank members created to advise the GOV on banking policy), pointed out to econoff March 14 that, if one includes the existing 16% reserve requirement, over 40% of a bank's lending ability is now constrained by the GOV. However, he said, the minimum lending requirements are not as big an imposition as the preferential interest rates, and that it was "tough for banks" to provide such a subsidy. Jose Barcia, Vice President of economic consultancy Metroeconomica, told econoff March 10 that he expected credit card rates, currently between 30 and 44% annually, to rise over 50% to compensate for the lower rates. When asked if rates would rise, Salvatierra answered, "theory says yes, (but with) competition, I don't know," given the enormous liquidity in the economy due to exchange controls. Pedro Coa, Vice President of Economic Studies at local bank Banesco, told econoff March 14 that he expected rates provided to savers on their accounts to drop as a consequence.

¶4. (C) Salvatierra also opined that it "makes little sense" to require over twice as much funding to go to construction loans, which last about two years, than to mortgages which last twenty, but noted this could be adjusted at a later time by CONAVI. Salvatierra and Barcia both observed that the 10% requirement would, at best, make a very small dent in the

housing deficit, estimated at 1.5 million homes, since 7% of bank lending portfolios would finance no more than 50,000

homes per year. (In a separate meeting with econcouns, Construction Chamber President Alvaro Sucre said that while in principle, he opposed such interference in private economic decision, he hoped that the new lending requirements would indeed spark a significant recovery in his sector.)

USURY - WHAT WASN'T ILLEGAL THEN IS NOW

¶5. (U) While they adjust to the new lending requirements, Venezuela's bankers face pressure on another front. Though they have not yet been charged with any crimes, seven private bank presidents (including the heads of Banesco and Banco Mercantil, the two top locally owned banks, and the head of Spanish-owned Banco de Venezuela), one former head of the Superintendency of Banking (SUDEBAN, a GOV agency), and two former Venezuelan Central Bank Presidents (including the recently retired Diego Castellanos, were prohibited from leaving the country by a February 21 court decision. The restriction was mandated because those individuals, along with some other ex-SUDEBAN employees, are being investigated and will possibly face charges of usury and fraud. The investigation stems from a Supreme Court decision in January 2002, in which it ruled that loans with interest rates indexed to inflation, and loans with balloon payments, were unconstitutional. The Supreme Court made its ruling retroactive. The actions upon which the charges would be based pre-date the Supreme Court decision.

¶6. (C) Salvatierra, one of the bank presidents facing charges, told econoff that he and the other presidents "feel calm, and that we committed no crime." He claimed that the accusation "has no solid legal or economic base" because the loans in question were based in law, and also enabled poor people to obtain mortgages they would not have been able to otherwise. Salvatierra did acknowledge some doubt about the outcome given the increased politicization of the judiciary (reftel). He said, "there is an intent to create a negative perception of the banking sector," perhaps not with the intent of imprisoning anyone now, but "to send a message" for the future. Coa agreed, saying the GOV is perhaps "going after the banks," after destroying the independence of state-owned oil company PDVSA, the National Electoral Council (CNE) and other institutions which should be autonomous.

SUMMARY

¶7. (C) Profits in the banking sector soared 44% in 2004 over 2003, with an impressive 43.3% return on equity. In addition, GDP in the financial services sector was up 26.6% in 2004 (vs. 17.3% for overall GDP), after being the only private sector to show GDP growth in 2003. The lion's share of this growth came from investments in government securities issued to allow free spending policies to continue. Exchange controls, which prevent borrowers from moving their money out of the country where they could get better returns, have also been enormously beneficial to the banks. Thus, they are poorly positioned to challenge these new requirements. Nonetheless, the imposition of directed lending and subsidized rates, historically common in Latin America, however, is bad regulatory policy. Inevitably it will force banks to make loans to customers who would otherwise be too shaky to qualify, eventually damaging portfolio quality, while driving up rates for good customers in other sectors. We suspect that the usury case against the bank heads constitutes pressure to make them go along with the policy relatively quietly. It also raises yet another populist target for the bolivarian government, which is ever alert against exploitation and profiteering by the private sector.
Brownfield

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